

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Pescetti Analyst: John Pavalasky Bill Number: AB 1114  
Related Bills: See Legislative History Telephone: 845-4335 Introduced Date: February 23, 2001  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Environmental Remediation Expense Deduction/Include Costs of Hazardous Material Control or Abatement

### SUMMARY

This bill would:

- enact the "Brownfields Redevelopment Act of 2001" in the Health and Safety Code, and
- allow a deduction, under the Revenue and Taxation Code (R&TC), for the cost of cleaning up contaminated sites identified by the California Environmental Protection Agency (CAL-EPA).

This analysis will discuss only the deduction allowed under the R&TC since CAL-EPA, not the Franchise Tax Board (FTB), would administer the remainder of this bill.

### PURPOSE OF THE BILL

According to the author's staff, the purpose of this legislation is to speed up the cleanup process for brownfields so they can be put back into productive use.

### EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2002, and apply to taxable years beginning on or after January 1, 2002.

### POSITION

Pending.

### Summary of Suggested Amendments

Substantive amendments are necessary to resolve the implementation considerations discussed in this analysis. Department staff is available to help develop the necessary language to address these considerations as the bill moves through the legislative process.

Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

04/06/01

## **ANALYSIS**

### FEDERAL/STATE LAW

The federal Taxpayer Relief Act of 1997 (P.L. 105-34) originally enacted the provision that allows taxpayers to elect to treat certain "environmental remediation expenditures" that would otherwise be chargeable to the capital account (as part of the cost of the land) as deductible in the year paid or incurred (Internal Revenue Code (IRC) sec. 198). The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site.

A "qualified contaminated site" generally is any property that:

- (1) is held for use in a trade or business, for the production of income, or as inventory;
- (2) with respect to expenditures paid or incurred before 12-21-2000, is certified by the appropriate state environmental agency to be located within a targeted area; and
- (3) contains (or potentially contains) a hazardous substance (so-called "brownfields").

Targeted areas for expenditures paid or incurred before 12-21-2000, are defined as:

- (1) empowerment zones and enterprise communities as designated under present federal law;
- (2) sites announced before February of 1997 as being subject to one of the 76 Environmental Protection Agency ("EPA") Brownfields Pilots;
- (3) any population census tract with a poverty rate of 20% or more; and
- (4) certain industrial and commercial areas that are adjacent to tracts described in (3) above.

However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 cannot qualify.

A taxpayer that pays or incurs an "environmental remediation expenditure" during the period from 8-5-97 through 12-31-2003, is allowed to elect to deduct that amount on the federal return as an expense deduction in that year (i.e., is not required to capitalize the expense as part of the cost of the land), even though absent this provision they otherwise would have been required to capitalize these costs.

California law required the same treatment as elected on the federal return except that to avoid capitalization of the cost as part of the land, the "environmental remediation expenditure" had to be paid or incurred before January 1, 2001, since California has not conformed to the federal extension of the expiration date for eligible expenditures contained in the Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170) and the Consolidated Appropriations Act, 2001 (P.L. 106-554).

### THIS BILL

This bill, under the Personal Income Tax Law (PITL), would allow non-corporate taxpayers to elect to deduct as an expense (and not capitalize) any "environmental remediation expenditure" amounts paid or incurred in connection with the abatement or control of hazardous materials at property identified by CAL-EPA under the "Brownfields Redevelopment Act of 2001."

## IMPLEMENTATION CONSIDERATIONS

Under California law, the election of a taxpayer to deduct the costs of cleaning up contaminated sites ("environmental remediation expenditures") **expired** with respect to expenses paid or incurred on or after January 1, 2001. That election enabled a taxpayer that otherwise would be required to capitalize these costs and add them to the cost of the land to instead deduct the "environmental remediation expenditure" as a current expense. The author may wish to provide the complete rules in California law with respect to this expensing deduction since, even under the federal rules currently in operation, the costs paid or incurred with regard to cleanup of CAL-EPA identified sites might not qualify for the federal deduction.

## **LEGISLATIVE HISTORY**

AB 2797 (Machado, Stats. 1998, Ch. 322) conformed California to the federal environmental remediation expenditure provision for taxable years beginning on or after January 1, 1998.

## **PROGRAM BACKGROUND**

If a taxpayer acquires property in clean condition and contaminates it in the course of the taxpayer's business operations, the cost of restoring the property to its approximate condition at the time of acquisition doesn't result in a permanent improvement that increases the property's value, but yet the restoration costs are deductible.

This restoration principle does not apply to instances in which the taxpayer acquires property that is already in a contaminated state. The cleanup expenses must be capitalized as part of the cost of the land if the remediation results in a permanent improvement or betterment of the property that increases its value, prolongs its useful life, or adapts it to a new or different use. A taxpayer that pays or incurs an "environmental remediation expenditure" during the period from 8-5-97 through 12-31-2003, is allowed to elect to deduct that amount on the federal return as an expense deduction in that year (i.e., is not required to capitalize the expense as part of the cost of the land) even though they otherwise would have been required to capitalize these costs.

## **OTHER STATES' INFORMATION**

**Florida** has no comparable election for individuals since it has no individual state income tax. However, **Florida** allows a corporation to take a credit for a percentage of the costs of a voluntary cleanup of a contaminated site. To be eligible, a corporation must have received a tax credit certificate issued by the Florida Department of Environmental Protection.

**Illinois** and **Massachusetts** allow individuals and corporations to take a credit for a percentage of the costs of a voluntary cleanup of a contaminated site (brownfields credit). To be eligible, the individual or corporation must have received approval issued by that states' Department of Environmental Protection or other certifying agency.

**Michigan** allows corporations but not individuals to take a credit for a percentage of the costs of a voluntary cleanup of a contaminated site (brownfields credit).

**Minnesota** and **New York** conform to the federal law deduction for environmental remediation expenses for individuals and corporations.

These states were examined due to similarities to California of those states' population and business activity.

### **FISCAL IMPACT**

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

### **ECONOMIC IMPACT**

California was in conformity with federal law as it relates to environmental remediation expenditures incurred before January 1, 2001. This law was not extended and California no longer conforms to the Internal Revenue Code Section 198. Therefore, this bill, as currently drafted, would not affect PITL and Bank and Corporation Tax (B&CTL) tax liabilities.

### **ARGUMENTS/POLICY CONCERNS**

This bill would not allow corporations to elect to take this deduction. If the author wishes to allow this election to corporations, the bill should be amended to include a corresponding provision under the B&CTL.

### **LEGISLATIVE STAFF CONTACT**

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